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November 1, 1999

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

BY HAND DELIVERY

Ms. Magalie Roman Salas
Secretary, Federal Communications Commission
455 12th Street, S.W.
Room TW B204
Washington, D.C. 20554

Re: *AT&T/MediaOne Merger*, CS Docket No. 99-251

Dear Ms. Salas:

Enclosed please find an original and four copies of the Ex Parte Reply Comments of GTE Service Corporation, GTE Internetworking, and GTE Media Ventures, Inc. Supporting Denial of Applications or Conditioning Merger on Open Access Requirements. Pursuant to the Commission's Public Notice dated August 23, 1999, please accept this document as a written ex parte submission in the above referenced proceeding.

Thank you for your assistance, and please do not hesitate to direct any questions concerning this submission to me or to May Chan at GTE, who can be reached at (202) 463-5292.

Sincerely,

John P. Frantz

Enclosure

cc: To-Quyen Truong
Frances Eisenstein
Walter Strack
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Before the
Federal Communications Commission
Washington, D.C. 20554

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

In the Matter of	)	
	)	
Applications for Consent to the Transfer of Control of Licenses	)	
	)	
MediaOne Group, Inc.	)	
	)	CS Docket No. 99-251
Transferor,	)	
	)	
To	)	
	)	
AT&T Corp.,	)	
	)	
Transferee.	)	

EX PARTE REPLY COMMENTS OF GTE SERVICE CORPORATION, GTE INTERNETWORKING, AND GTE MEDIA VENTURES, INC. SUPPORTING DENIAL OF APPLICATIONS OR CONDITIONING MERGER ON OPEN ACCESS REQUIREMENTS

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November 1, 1999

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Transferee.	)	

EX PARTE REPLY COMMENTS OF GTE SERVICE CORPORATION, GTE INTERNETWORKING, AND GTE MEDIA VENTURES, INC. SUPPORTING DENIAL OF APPLICATIONS OR CONDITIONING MERGER ON OPEN ACCESS REQUIREMENTS

Pursuant to the Public Notice issued by the Commission on July 23, 1999, GTE Service Corporation, GTE Internetworking, and GTE Media Ventures, Inc. (collectively "GTE") respectfully submit these Ex Parte Reply Comments supporting denial of the Applications of AT&T Corp. ("AT&T") and MediaOne Group, Inc. ("MediaOne") for authority to transfer control of MediaOne's licenses to AT&T or, in the alternative, conditioning of the merger on open access requirements.

INTRODUCTION AND SUMMARY

Read AT&T/MediaOne's Reply Comments and you will search in vain for an answer to the question that holds the key to understanding the pending merger's competitive effects: *Why MediaOne?* Of all the cable companies in the United States, why did AT&T choose to merge with MediaOne? If AT&T were genuinely interested in achieving "the enormous scale and scope" necessary to compete in the local marketplace, Reply at 2, why did it not choose to acquire Comcast, which has roughly as many customers as MediaOne? If AT&T were truly interested in acquiring a cable provider with a "head start in deploying cable telephony" and "know-how that will enable AT&T to jump-start its deployment of cable telephony on the TCI system," Reply at 18, why did AT&T not choose to acquire Cox Communications, which has had far more success as a cable-based CLEC than MediaOne? The answer -- the one thing that MediaOne has that is not shared by any other comparably sized cable provider -- is Road Runner. Given AT&T's own recent admission that "the entire TCI acquisition came about because AT&T wanted to get its hands on At Home,"[1] there is no question that the purpose of this merger is to acquire the only other significant broadband ISP, Road Runner.

To determine whether the merger will have anticompetitive effects in the market for broadband services, the Commission should evaluate whether a combined AT&T/MediaOne will have both an incentive and ability to exercise market power. As to *incentive*, gaining early control over the broadband marketplace will allow a combined AT&T/MediaOne to protect or

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[1] Rebecca Blumenstein, *Inside the Tangles of AT&T's Web Strategy*, WALL ST. J., Aug. 13, 1999, at B4.

expand *three* sources of monopoly rents. *First,* broadband Internet service -- with its emphasis on interactive video applications that compete directly for cable viewers -- poses a direct threat to AT&T/MediaOne's cable monopolies. By leveraging its monopoly power in the broadband access market into vertically related markets for broadband content, AT&T/MediaOne will assure that Internet competitors do not siphon its cable monopoly profits. *Second,* by expanding its market power over broadband access into vertically related markets for broadband content, software, and applications, AT&T will deny other broadband technologies (like DSL, satellite, and wireless) access to needed inputs. Lacking these critical building blocks, these alternative technologies will pose no threat to AT&T/MediaOne's ability to extract monopoly rents from broadband advertisers and e-merchants. *Third,* by controlling the roll-out of IP telephony, AT&T/MediaOne will limit the dissipation of revenues from its core line of business -- residential long distance service. Open cable systems, which afford customers their choice of ISP, allow multiple competitors to offer local and long distance IP telephony. (Just as numerous CLECs can provide competing local service over a copper loop, an open cable system can be used by every interconnected ISP to provide IP telephony.) But over a closed cable system covering the great majority of the country, AT&T/MediaOne will be the sole provider of IP telephony over cable. With a dominant share of the broadband market, AT&T will control the pricing and roll-out of IP telephony to assure that its long distance revenues are not cannibalized.

With respect to its *ability* to exert monopoly control over the broadband marketplace, by combining Excite@Home and Road Runner, AT&T/MediaOne would create the preeminent broadband ISP, serving over 80 percent of broadband customers. Analysts are in near-complete agreement that AT&T/MediaOne will control a customer share of this size for at least the next three years. The combined company would, as a result, have a long window of opportunity to consolidate its monopoly position by: (i) negotiating exclusive (and exclusionary) deals with leading broadband content and application developers; (ii) discriminating against outside content; and (iii) implementing proprietary network, hardware, and software protocols designed to encourage application developers to write for its broadband platform first.

AT&T/MediaOne offers, at bottom, two reasons why the combined company will be unable to exercise monopoly power in the broadband marketplace. AT&T/MediaOne first asserts that "broadband and narrowband" Internet services compete "for the same mass market of Internet subscribers," leaving a dominant broadband provider without any market power. Reply at 74. But this assertion is belied by AT&T's own business plan. AT&T already has a significant narrowband offering in its WorldNet service -- a service that is currently available throughout the AT&T and MediaOne service territories. Why, if narrowband service is a substitute for broadband, would AT&T be investing (in its words) "more than $100 billion" to upgrade its cable networks to provide the same service it already offers through WorldNet? Reply at 6. The answer -- confirmed by copious economic evidence and a simple comparison of the services offered over broadband and narrowband connections -- is that these services are not substitutes.

Moreover, AT&T/MediaOne's argument ignores the fact that the anticompetitive strategies wielded by the combined company will be targeted exclusively at competing broadband providers. GTE has never suggested that AT&T/MediaOne would use its broadband market power to raise the price of its services -- an action that may spur customers to return to narrowband if, as AT&T/MediaOne erroneously asserts, the two services compete. Rather, by negotiating exclusionary contracts with broadband suppliers, discriminating against outside broadband content, and implementing proprietary protocols that affect the operation of broadband applications, AT&T/MediaOne can target its anticompetitive acts to injure only competing broadband providers. Customers -- even those upset over the loss of access to *some* broadband content -- would never switch back to narrowband in response to these targeted actions, because doing so would mean losing access to *all* broadband content. As Professor Gertner concludes, the "existence of narrowband customers would not prevent AT&T from successfully engaging in a strategy that harms a distinct group of customers that prefer broadband-specific services." Ex Parte Reply Declaration of Robert H. Gertner, attached as Appendix A, at ¶ 16 ("Gertner Reply Declaration"). The existence of narrowband service will therefore do nothing to discipline AT&T/MediaOne's exercise of broadband market power.

Facing no competition from narrowband Internet service, AT&T/MediaOne next asserts that "broadband alternatives to cable modem service are a real and vibrant presence in the marketplace." Reply at 80. Although AT&T/MediaOne claims that GTE and others "resort to disparaging their own services," *id.*, nothing could be further from the truth. GTE's concern has always been that the merger will allow the combined company -- by locking up control over key content, software, and application inputs -- to keep other broadband technologies from competing in the marketplace. Thus, far from disparaging its own DSL service or other broadband access technologies, GTE has identified limitations on the current *reach* of those services that will keep them from disciplining the market power of a combined AT&T/MediaOne. These limitations are widely recognized, and indeed are the reason why analysts predict cable will maintain an 80 percent broadband market share until at least 2003.[2]

By that time, the broadband race will be over. AT&T/MediaOne will have exclusive control over the most popular broadband content and applications, will have propriety protocols in place that maintain its dominant control over broadband applications, and will have filled its customers' homes with expensive equipment that cannot be used with the services of competitors. The persistent anticompetitive harm created by such an advantage -- and the difficulty of dismantling such a monopoly after the fact -- is proven by the Justice Department's suit against Microsoft. There, Microsoft established a durable monopoly over the market for PC operating systems by building a large customer base and, through a combination of closed protocols and network effects, encouraged software developers "to write first and foremost to Windows."[3] Thus, "Microsoft's high market share [led] to more applications being written for its operating system, which reinforce[d] and increase[d] Microsoft's market share, which in turn [led] to still more applications being written for Windows than for other operating systems, and so on."[4] Likewise, AT&T/MediaOne is -- by combining Excite@Home and Road Runner -- creating a unitary platform through which its customers will access all broadband applications

---

[2] See Petition of GTE Service Corporation, GTE Internetworking, and GTE Media Ventures, Inc. to Deny Application or, in the Alternative, to Condition the Merger on Open Access Requirements, at 30-31 (Aug. 23, 1999) ("GTE Comments").

[3] *United States v. Microsoft Corp.*, No. 98-1233, Plaintiffs' Joint Proposed Findings of Fact -- Revised, at ¶ 25.2 (Sept. 10, 1999).

[4] *Id.*

and content. With two to three years to operate this closed platform against little competition, AT&T/MediaOne will be able to ensure its ability to dominate other broadband access technologies just as Microsoft controls the market for PC operating systems.

Ultimately, consumers will suffer. Residential customers will have only one choice of broadband provider -- with competing technologies hamstrung by lack of access to needed inputs; advertisers will have to pay inflated prices to reach broadband customers; and e-commerce merchants and customers will have to pay a monopoly tax to AT&T/MediaOne on every transaction. The magnitude of these harms is sufficiently great to render the pending transaction contrary to the public interest. The Commission must therefore deny the applications for transfer of control unless *AT&T and MediaOne* -- not GTE -- propose conditions that reverse the balance and make the merger procompetitive. GTE has endeavored to assist the Commission in this exercise, proposing detailed conditions that are narrowly tailored to address the merger's competitive harms. By asserting that these conditions are "horrendous public policy" and "illegal," Reply at 4, AT&T and MediaOne do nothing but shoot themselves in the foot.

Nevertheless, GTE continues to believe that the Commission can craft merger conditions that will solve the merger's competitive harms without dampening investment incentives or creating extreme regulatory entanglements. The optimal remedy is to condition the merger on a requirement that AT&T and MediaOne open their cable systems to competing ISPs -- a solution that is eminently workable based on existing technology, will readily accommodate the development of new broadband services, and will maximize consumers' choice of ISPs and IP telephony providers. But should the Commission conclude that the regulatory burdens associated with GTE's proposed open access conditions are untenable, the Commission should, at a minimum, impose the following second-best combination of conditions to mitigate the competitive foreclosure concerns raised by the merger.[5]

(1) *Require AT&T to divest its interest in Excite@Home*, separating control over the dominant broadband ISP from the dominant cable provider.

(2) *Cap the number of customers AT&T/MediaOne can serve through any one ISP* at the greater of (i) 2,000,000; or (ii) 50 percent of the total AT&T/MediaOne customers that have a choice of three or more ISPs. This will preclude any one broadband ISP from becoming large enough to dominate the market and will encourage AT&T/MediaOne, without regulatory oversight, to offer consumers a choice among ISPs. Moreover, it will work no hardship on AT&T/MediaOne because the combined company is nowhere near the cap today.

(3) *Bar AT&T/MediaOne from negotiating exclusive contracts with broadband content, software, and application developers*, to ensure that it does not foreclose competitors' access to needed inputs.

(4) *Bar AT&T/MediaOne from incorporating any proprietary software, hardware, or protocols into the content, applications, or equipment associated with its provision of broadband services*. This condition will guarantee that AT&T/MediaOne does not gain an anticompetitive advantage by promoting the development of applications and customer equipment that work only with its own service.

Alternatively, the Commission can deny the applications for transfer of control outright. Contrary to AT&T/MediaOne's assertion that the merger "is the only genuine hope for the emergence" of local telephone competition, Reply at 2, the *actual* benefits traceable to the merger can readily be accomplished through joint ventures.

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[5] While these conditions would help to mitigate the competitive concerns created by this merger, they would not eliminate in any way the antitrust violations raised by GTE in a private suit recently filed against TCI, Comcast, and Excite@Home. *See GTE Internetworking v. Tele-Communications, Inc.*, Case No. 99-1737, Complaint (W.D. Pa. Oct. 25, 1999). So long as TCI, Comcast, and Excite@Home customers remain unable to choose their own ISP, they will be subject to the private-suit defendants' unlawful tying and exclusive dealing scheme.

In the end, the Commission will have to decide which version of the facts better evidences AT&T/MediaOne's business intentions -- the statements offered to regulators by AT&T/MediaOne's attorneys and paid experts, or the marketplace statements made by its business people. GTE's opening comments were replete with quotations from AT&T's Chairman and other top executives confirming AT&T/MediaOne's anticompetitive plan. AT&T/MediaOne's Reply Comments did not address any of these statements. Nor have AT&T/MediaOne executives ceased making comments to the press that prove GTE's case. Indeed, Excite@Home's CEO, Thomas Jermoluk, gave an interview to *Salon* magazine just *four days* before AT&T/MediaOne filed its Reply.[6] This interview confirms virtually every point GTE has made in this proceeding:

(1) *Broadband and narrowband services are not in the same product market.*

> Q: When you started out, @Home was seen as a technology company, whose main mission was bringing high-speed Net connections into the home. Now, especially since you merged with Excite, your business is intimately wrapped up with building content. Why do you want to be on the content side of the media business?
>
> A. Two reasons. One is rather philosophical; one is economic. The philosophical one is that if you build a car and you make it with 12 cylinders instead of 10 cylinders, and so it's 10 percent faster, it's still a car, and people know how to use it. *But if you make it 100 times faster, you don't use it like you'd use your car anymore.* Our belief is that the content that will come down the wires in a broadband world will be very different. *It's not just that you're tired of looking at that little hourglass and you'll get your text-based pages faster, it's that you'll look at content a different way.*

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[6] Mark Gimein, *Broadband Warrior*, SALON, Sept. 13, 1999 <www.salonmagazine.com/tech/view/1999/09/13/jermoluk>.

(2) *Customers do not switch back to narrowband once they try broadband, nor do they change broadband providers.*

A: You're not going to turn off your local telephone and you're not going to turn off your Internet connection when you're on broadband in your home. *Our churn rate is nothing.*

(3) *AT&T/MediaOne is using its monopoly power over broadband access to gain an advantage in vertically related markets for broadband content, applications, and e-commerce.*

A: The second answer is economic. Over time, long distance became a commodity. [It's becoming the same with] Internet stuff: Buy a computer and give access away, or buy the access and give the computer away. The subscription part of what we do is $40 [a month] and that will move down over time. . . .

I don't think there's anyone who will argue that 10 years from now we will be making more money from subscription revenue than we do today. Given this, I want to be on the other side of the equation, I want to make some money on what people are doing by gaining access, not just on the access.

(4) *AT&T/MediaOne has captured the broadband first-mover advantage, plans to negotiate advantageous partnerships with content providers, and will create new closed protocols.*

A: Because *we're inventing this technology* we feel that *we're the best ones to create the technological environment* from the content side as well. [But] we aren't content creators. *We're a partner for content creators.*

(5) *AT&T/MediaOne's present conduct will not be disciplined by competitors' actions two or three years in the future. The relevant time-horizon is much shorter.*

Q: How far ahead do you look in your planning?

A: The vast majority of our planning is within a *two-month horizon.* It's pretty rare to have the luxury of actually being able to sit back and know what this will look like in a couple of years.

(6) *AT&T/MediaOne's ultimate goal is to reassemble AT&T's old monopoly.*

> Q: Where does Excite@Home fit in the big scheme of AT&T?
>
> A: We are the sharp end of the spear for their entry into the world of IP technology. Everybody, AT&T included, believes that one day all of the current modes of transmission will become IP. Data is the first [part of it]. Voice will go that way; video will go that way. . . .
>
> What everybody is trying to do is *re-create the old AT&T, the vertical AT&T*. What you need is the last loop, the backbone, and the ability to offer services [like TV, telephone and Internet] across the whole thing. That's the golden goose.

The AT&T/MediaOne merger thus presents -- by the parties' own admissions -- a very real threat to the public interest. GTE therefore respectfully requests that the Commission deny the applications for transfer of control, or approve the merger subject only to the open access conditions proposed in GTE's opening comments.

ARGUMENT

I. BROADBAND INTERNET SERVICE IS A DISTINCT PRODUCT MARKET FROM NARROWBAND INTERNET SERVICE.

AT&T/MediaOne asserts that GTE is "plainly wrong in claiming that there is a separate market for 'broadband Internet'" service. Reply at 71. As noted above, this opinion seems to be shared widely among AT&T/MediaOne's attorneys and experts, but not among any of the parties' business people. As AT&T Chairman C. Michael Armstrong said, "Tomorrow, it's not a narrowband world being optimized. It's a broadband world."[7]

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[7] C. Michael Armstrong, *Networking: The New Generation Comes of Age*, Speech Before ComNet/DC '99 Conference, Jan. 26, 1999 <www.att.com/speeches>.

AT&T/MediaOne offers three justifications for its assertion that broadband and narrowband services are part of the same product market. *First,* the parties claim that "broadband service is priced competitively with narrowband service." *Id.* at 72. This statement is factually untrue. As Professor Gertner observes, "many ISPs now offer service for as little as $10 per month" and others "offer narrowband Internet access at no charge." Gertner Reply Declaration ¶ 10 & table 1. This compares to an average price of $40 to $50 per month for Excite@Home and Road Runner service -- a $30 to $40 differential in the price of narrowband and broadband services. *Id.* ¶ 9.

AT&T/MediaOne attempts to reduce this differential by including the price of a second telephone line in the monthly cost of narrowband service, arguing that it "is appropriate to include the cost of a second line when computing the price of cable modem with the price of dial-up access." Reply at 72 n. 206. But as Professor Gertner explains, even "for homes that purchase a second telephone line for narrowband access, and many do not, the second line provides services other than Internet access." Gertner Reply Declaration ¶ 12. It is therefore incorrect for AT&T/MediaOne to include the full cost of a second line into the price for narrowband service, given -- as AT&T/MediaOne's own economists admit -- customers "can use that second line for regular voice communication, as well as for fax."[8] Thus, when AT&T/MediaOne prices narrowband service at "$20 for the telephone line and $20 for Internet service," it overstates each component of the total by at least half . Even if the full $20 cost of a second telephone line is

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[8] Declaration of Janusz A. Ordover & Robert D. Willig, attached as Appendix A to AT&T/MediaOne's Reply Comments, at ¶ 83 ("Ordover & Willig Declaration").

added to the average $10 price of dial-up connectivity, broadband service is still $10 to $20 per month more expensive than narrowband -- a price differential ranging from 33 to 66 percent.

Moreover, a more detailed look at the prices for second lines confirms that broadband and narrowband services are not part of the same product market. If, as AT&T/MediaOne asserts, the cost of a second telephone line should be included in the price of narrowband service and the availability of narrowband service disciplines the pricing behavior of broadband providers, then broadband prices should be lower in markets where second line prices are lower. They are not. As explained in the Ex Parte Reply Declaration of Jerry A. Hausman and J. Gregory Sidak, attached as Appendix B ("Hausman & Sidak Reply Declaration"), prices for second telephone lines vary "from $7.70 to $47.62 per month." *Id.* ¶ 32. Thus, by AT&T/MediaOne's calculus, "narrowband access prices differ by a factor of over 300 percent." *Id.* Nevertheless, the price for broadband access does "not vary in any way with these differences." *Id.* Based on this econometric analysis -- detailed in full in Paragraphs 31 through 36 of their attached Reply Declaration -- Hausman & Sidak conclude that "variations in the price of narrowband access cannot explain variations in the price of broadband access." *Id.* Empirical evidence therefore confirms that AT&T/MediaOne is incorrect when it asserts that the availability and price of narrowband services discipline the market power of broadband providers.

Second, in defense of its effort to conflate the markets for broadband and narrowband Internet services, AT&T/MediaOne claims that "consumers use both narrowband and broadband for the same core applications." Reply at 72. This assertion is premised on the observation that the "vast majority of Internet applications, such as e-mail and Web access" are available over narrowband connections and "the vast majority of content available to consumers . . . is not tailored to higher bandwidth speeds." *Id.* AT&T/MediaOne's argument on this score is nothing more than a shell game. It relies on the fact that broadband service is a substitute for narrowband -- a fact that is not relevant to determining whether the behavior of a broadband monopolist is disciplined by the availability of narrowband service -- to conclude that narrowband service is a substitute for broadband. As Hausman and Sidak observe, while "all narrowband applications are supported by broadband Internet connections, the same is not true in reverse -- a growing majority of broadband applications cannot be supported over narrowband." Hausman & Sidak Reply Declaration ¶ 21. Thus, it is simply irrelevant that consumers can check e-mail and access the Web over a narrowband connection. The relevant question is whether narrowband service supports quality real-time video, home networking, video on demand, distance learning, high-speed telecommuting, and all the other broadband services that have yet to be invented. The answer to that question -- as confirmed by AT&T/MediaOne's own business people -- is no. As Excite@Home's own Web site states, with "AT&T@Home you will experience intense multimedia content that your 28.8 or 56k phone modem is too wimpy to deliver."[9]

Furthermore, even accepting AT&T/MediaOne's erroneous assertion that the only difference between broadband and narrowband "is the speed or quality at which the content downloads,"[10] a broadband monopolist would *still* not de disciplined by the availability of narrowband service. Practically speaking, the only difference between taking a flight from

[9] *The Cable Internet Revolution,* visited Oct. 31, 1999 <athome.att.com/pages/about>.

[10] Ordover & Willig Declaration ¶ 92.

Washington, D.C. to Chicago (which takes less than two hours) and taking a train between the two cities (which takes roughly 16 hours) is speed. People typically do not see the train as a substitute, however, because the difference in price between the train and airline tickets is massively outweighed by the value of the time lost by taking the slower mode of transport.

Broadband and narrowband services can be analyzed in precisely the same way.[11] To accomplish this task, Hausman & Sidak conducted a critical share analysis that measures the number of broadband customers who would switch back to narrowband in the face of a hypothetical five percent price increase. (This approach is recommended by the Justice Department's *Merger Guidelines* to determine whether two products are part of the same market.) Hausman & Sidak's analysis -- detailed in Paragraphs 24 through 30 of their attached Reply Declaration -- confirms that broadband customers value the saved leisure time that comes with a broadband connection far more than the cost associated with a five percent price increase. "Consequently, a five-percent price increase would be profitable for a hypothetical monopolist to impose on consumers and thus according to the *Merger Guidelines*' market definition test, broadband Internet access represents a separate antitrust market." Hausman & Sidak Reply Declaration ¶ 30. When one casts aside AT&T/MediaOne's counter-factual assumption that broadband and narrowband connections offer identical services, this conclusion becomes even more firm.

[11] As Excite@Home's Web site again attests, "a file that takes 9 minutes to download over a 28.8 phone modem would take . . . 2 seconds on AT&T@Home." *How Fast Is AT&T@Home*, visited Oct. 31, 1999 <athome.att.com/pages/faq>.

Third, AT&T/MediaOne asserts that "at the present time and for years to come broadband and narrowband will be competing for the same mass market of Internet subscribers." Reply at 73-74. This point again only proves that broadband service is a substitute for narrowband -- a proposition that is entirely irrelevant to this proceeding. As Professor Gertner notes, the "fact that broadband access customers are drawn from the pool of narrowband customers does not imply that these products are in the same market." Gertner Reply Declaration ¶ 6. Indeed, "customers of virtually all new products and services are drawn from the ranks of the customers of the services that are displaced. By this logic, airlines and passenger railroads would be in the same market because air travelers were drawn from the population of people who once traveled by rail." *Id.* But again, the fact that air travel is a substitute for railroad travel *says nothing* about whether the behavior of an airline monopolist would be disciplined by the prices of train tickets. Professor Gertner concludes: "Even if the pricing of a new technology is made to attract customers of an older technology, this does not necessarily suggest that customers would revert to the old technology if its price falls, as would be expected if the new and old products are in the same product market." *Id.* ¶ 7.

AT&T/MediaOne concludes by offering an analogy to support its position that narrowband and broadband services are part of the same product market, observing that a "car with more features and higher price is, within some range, in the same market as one with less features and a lower price." Reply at 75 (citation omitted). Apparently, AT&T/MediaOne's attorneys did not consult with Excite@Home CEO Thomas Jermoluk, who exploded this analogy just four days before AT&T/MediaOne filed its Reply: "[I]f you build a car and you make it with

12 cylinders instead of 10 cylinders, and so it's 10 percent faster, it's still a car, and people know how to use it. But if you make it 100 times faster, you don't use it like you'd use your car anymore. Our belief is that the content that will come down the wires in a broadband world will be very different."[12]

The proper analogy for analyzing the competitive consequences of the AT&T/MediaOne merger is the effect that early television had on the development of radio. Radio was, before the introduction of television, the primary source of in-home news and entertainment for most Americans. When television first came on the scene, it could only succeed by encouraging radio listeners to become television viewers. Nevertheless, these services were not then -- nor are they today -- part of the same product market. No one would seriously argue that one company should be able to own every television station in the country just because consumers can escape the monopolist's grasp by turning on the radio. Likewise, at the time television was invented, the Commission would never have permitted the sole manufacturer of TV sets to buy every programmer and offer consumers sets with only one channel. But that is precisely what AT&T/MediaOne is attempting to do here. Broadband is a new market -- as different as radio and television -- and AT&T/MediaOne is attempting to lock up the lion's share of outlets for the distribution and creation of broadband content.

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[12] Mark Gimein, *Broadband Warrior*, SALON, Sept. 13, 1999 <www.salonmagazine.com/tech/view/1999/09/13/jermoluk>.

II. A COMBINED AT&T/MEDIAONE WOULD HAVE MONOPOLY POWER IN THE MARKET FOR BROADBAND INTERNET SERVICE.

AT&T/MediaOne asserts that the combined company will be unable to seize the broadband "first mover" advantage because "the Internet access market is vigorously competitive." Reply at 79, 85. Nevertheless, it is a fact that the combined company would control more than 90 percent of cable modem subscribers and well over 80 percent of all broadband subscribers. The most recent estimates give Excite@Home 530,000 domestic customers and Road Runner 420,000 -- totals that reflect a 33 percent growth rate in the third quarter of 1999 alone.[13] AT&T/MediaOne asserts that there are "almost two hundred thousand DSL lines in service in the United States," *id.* at 80, even though the source AT&T/MediaOne cites puts the total at only 159,159, and that number includes almost 43,000 *business* customers.[14] AT&T/MediaOne's Reply therefore misrepresents the total number of *residential* DSL customers -- the only relevant measure here -- by roughly 50 percent.

In its conference call reporting third quarter results, Excite@Home reported that its *own* "market share for North American broadband is now over 70 percent."[15] With Road Runner added, there is no question that AT&T/MediaOne's market share will be close to 90 percent.

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[13] Andrea Orr, *ExciteAtHome Reports Small Third Quarter Loss*, CBS MARKETWATCH, Oct. 19, 1999 <www2.marketwatch.com/quotes/articles>; *Road Runner Said It Added Record 100,000 Subscribers*, COMMUNICATIONS DAILY, Oct. 12, 1999, at 9.

[14] *See* TeleChoice, *DSL Deployment Surges Well Beyond Projections*, Aug. 16, 1999 <www.telechoice.com/content/pressreleases/8171999.asp>; TeleChoice, *Deployment -- Updated*, Aug. 1999 <www.xdsl.com/content/resources/deployment_info.asp>.

[15] Excite @Home 1999 Q3 Earnings Conference Call, Oct. 19, 1999 <www.corporate-ir.net/ireye/ir_site.zhtml?ticker=athm&script=110 0>.

AT&T/MediaOne attempts to deflect attention from this fact with three lines of argument. *First*, AT&T/MediaOne claims that the pending merger is "not" a "merger of @Home and Road Runner." Reply at 4. Again, this assertion cannot be squared with the public statements of AT&T/MediaOne executives. As Charles Moldow, an Excite@Home vice president stated just before the AT&T/MediaOne merger was announced, it "doesn't make sense to have two national backbones. The economics are better for there to be just one. It would seem to make a lot of sense to put these things together."[16] Thus, Moldow concluded on the prospect of an Excite@Home/Road Runner combination, "I can't imagine it not happening."[17]

Second, AT&T/MediaOne has attempted, through numerous press reports, to convince the Commission that it intends to open its cable network, "welcom[ing] and in fact pursu[ing] multiple providers on the AT&T cable infrastructure."[18] To the contrary, AT&T/MediaOne has made clear that it plans to honor its exclusive commitment to Excite@Home until 2002.[19] In Internet time, three years is an eternity. As explained in the Ex Parte Reply Declaration of Albert Parisian, attached as Appendix C ("Parisian Reply Declaration"), two or three years "is more than enough time to make proprietary changes to customer hardware and fill customers' homes with equipment that does not work with any other provider's services." *Id.* ¶ 4. Indeed,

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[16] Corey Grice & Ben Heskett, *@Home Considers Road Runner Pairing*, CNET NEWS.COM, Feb. 4, 1999 <news.cnet.com/news/0-1004-200-338296.html?tag=st.cn.1002newsfd>.

[17] *Id.*

[18] *AT&T Isn't Planning Any Deal With ISPs Such As AOL*, COMMUNICATIONS DAILY, Oct. 12, 1999, at 9.

[19] *Id.*

Excite@Home has admitted to the Commission staff that it is *already* in the process of making closed and proprietary changes to cable modems and cable modem termination systems. *Id.* ¶ 3. Moreover, "because broadband application and software writing is in its nascency, developers will write to the standard that reaches the largest number of customers." *Id.* ¶ 4. Three years will afford AT&T/MediaOne more than enough time to develop its own closed set of proprietary protocols, giving it a permanent anticompetitive advantage in the broadband marketplace. *Id.*

Third, AT&T/MediaOne identify a number of competing broadband technologies that ostensibly will limit the combined company's exercise of market power. For example, AT&T/MediaOne devotes three pages of its comments to listing fledgling satellite and wireless broadband providers. Reply at 82-85. Nevertheless, AT&T/MediaOne does not seriously dispute that these nascent technologies will not have a perceptible impact on the marketplace until at least 2002. By that time, the broadband race will be over.

The only broadband access technology that AT&T/MediaOne reasonably can claim presents a threat to the merged company's hegemony is DSL. AT&T/MediaOne cites one analyst report suggesting that "the number of DSL subscribers growing at a significantly faster rate than that for cable modem services" and projecting that "there will be half a million DSL subscribers by the end of 1999." Reply at 80. Nevertheless, as GTE detailed in its opening comments, the great majority of analysts predict that cable modems will continue to maintain a 75 to 80 percent share of the broadband market until 2002.[20] It is therefore highly unlikely that DSL competition will deny AT&T/MediaOne its first-mover advantage.

AT&T/MediaOne asserts that "the only real limitation on DSL technology is the unwillingness of ILECs to make the necessary investments." *Id.* at 80. This argument fundamentally misconceives the calculus that GTE must consider when deciding which markets to target with DSL service. When making this evaluation, GTE must weigh the potential revenue stream that will be generated by offering high-speed access and compare that stream to the cost of capital required to deploy the service. Only if the present value of the investment is positive and more favorable than other investments GTE could make with its limited resources (expanding its Internet backbone network, for example), will the company build out DSL service in a particular market. *See* Ex Parte Reply Declaration of Dale E. Veeneman & Evertt H. Williams, attached as Appendix D ("Veeneman & Williams Reply Declaration"), at ¶ 6.

Cable providers, on the other hand, face a fundamentally different calculus when deciding whether to upgrade their networks to provide cable modem service. Cable plant upgrades that enable an MSO to offer cable modem services support at least *three* distinct lines of revenue. *First*, cable providers secure customer revenues through the sale of broadband access -- the revenue stream comparable to what GTE earns with DSL. *Second*, cable providers are able to earn revenues from the sale of broadband ISP services, advertising, and e-commerce. Because cable providers are not required (as is GTE) to afford competing ISPs access to its customers, the

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[20] GTE Comments at 30-31; Declaration of Daniel L. Rubinfeld & J. Gregory Sidak, attached as Appendix B to GTE's opening comments, at ¶ 45.

revenues created by this offering are greater for cable providers. *Third*, cable upgrades that support cable modem service also support entirely new and separate product offerings, including interactive television and cable telephony. With more streams of revenue supporting network upgrades, cable providers can expect a much greater return on their investment than DSL providers. It is therefore a non-sequitur for AT&T/MediaOne to assert that, because cable providers have invested "tens of billions of dollars" in cable upgrades,[21] DSL providers are "unwilling[] . . . to make the necessary investments" if they do not spend the same amount.[22]

AT&T/MediaOne points to the fact that "DSL was devised in 1987" to suggest that GTE and others have slow rolled DSL deployment for fear of "cannibalizing T-1 revenues." Reply at 13. But until recently, there has not been enough demand for residential high-speed access to justify the significant investment required to deploy and mass-market DSL. Veeneman & Williams Reply Declaration ¶ 7. Moreover, not until the end of 1997 did DSLAM equipment become commercially available at a price that would permit an economical DSL roll out. *Id.* Until that time, no major carrier -- including CLECs and IXCs -- launched a full-scale DSL deployment. *Id.* This lack of demand and cost-effective equipment -- not fear of cannibalizing T-1 sales -- is the reason why GTE did not commence its DSL deployment until 1998. Indeed, T-1 service is not even marketed to or purchased by residential customers, meaning that even the most comprehensive residential DSL roll out would not affect T-1 revenues. *Id.*

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[21] Ordover & Willig Declaration ¶ 17.

[22] Reply at 80.

Finally, AT&T/MediaOne claims that "technological advancements" have eliminated any limitations on DSL's potential reach. Reply at 80. Specifically, AT&T/MediaOne asserts that DSL services can now be offered "to residents with loops that are as much as 20 miles" away, that "next generation" technology allows ILECs to reach inexpensively customers whose loops are provisioned through DLCs, and that "introduction of the G.lite Standard" will promote the "availability of DSL service." *Id.* at 81. These claims -- all of which are false or highly misleading -- are addressed in detail in Paragraphs 10 through 18 of the attached Veeneman & Williams Reply Declaration. Suffice it to say, GTE is a strong believer in DSL's *long-term* ability to compete for most every broadband customer. Presently, GTE wants to ensure that the inputs needed to make the service succeed are not controlled by a vertically integrated monopolist. Indeed, if GTE believed that DSL would never be able to compete, it would have no reason to fear an AT&T/MediaOne combination.

III. AT&T/MEDIAONE WILL USE ITS BROADBAND MONOPOLY POWER TO PERMANENTLY DISADVANTAGE COMPETING BROADBAND ACCESS TECHNOLOGIES.

In its opening comments, GTE identified three significant strategies a combined AT&T/MediaOne could employ to gain a permanent advantage in the broadband marketplace. *First,* the combined company will, as a result of the architectural design of its network, be able to discriminate against outside content. *Second,* AT&T/MediaOne will, by virtue of its dominant combined customer base, be able to negotiate exclusionary contracts with broadband content and application developers. *Third,* and again due to the unrivaled size of its customer base, AT&T/MediaOne will be able to implement a regime of proprietary protocols designed to encourage content and application developers to write first for its system. AT&T/MediaOne's Reply never denies that the combined company would be able to engage in these strategies. Rather, the parties claim that they would have no *incentive* to behave anticompetitively. AT&T/MediaOne's response therefore devolves to the question of broadband market power addressed above. If the Commission concludes that AT&T/MediaOne will have broadband monopoly power -- giving the merged company an incentive to behave anticompetitively -- the parties have offered no denial of their combined *ability* to crush out broadband competition.

For example, in response to GTE's statement that the combined company would be able to discriminate against outside content, AT&T/MediaOne asserts that it "would have no *incentive* to restrict subscriber access to unaffiliated content and application because such options would drive customers away from AT&T's cable Internet services." Reply at 91 (emphasis added). Thus, the parties ask the Commission to rely on the fact that AT&T/MediaOne *currently* allows customers to "bypass . . . preferred content or applications by going straight to the Web." Reply at 91. But AT&T/MediaOne's ultimate goal is not to maximize the number of subscribers on its system; rather, its objective is to maximize profits. As explained by Hausman & Sidak, AT&T/MediaOne would have a strong incentive to discriminate against unaffiliated content providers because the gains on content margins (shared with affiliated content providers) would outweigh any losses in monthly access charges from departing customers. Hausman & Sidak Reply Declaration ¶¶ 44-46.

Moreover, AT&T/MediaOne's argument that such discrimination would cause customers to switch broadband providers assumes that a competing broadband network would afford customers access to a wider array of content. This assumption is flawed for two reasons. *First*, a significant percentage of the population will not have another broadband provider to turn to over the next three years. *Second*, by negotiating exclusionary contracts with broadband software and content providers and implementing a regime of proprietary protocols, AT&T/MediaOne will guarantee that competing broadband providers have far more anemic content than the combined company. Thus, just as most consumers did not switch to Apple because Microsoft discriminated against Netscape, so will AT&T/MediaOne's customers not switch providers when the merged company discriminates against outside content.

AT&T/MediaOne next asserts that content providers would have no *incentive* to agree to exclusive deals with the combined company "because doing so would dramatically cut into their audience size." Reply at 91. This argument defies commercial reality on the Internet. Content providers frequently agree to exclusive deals with distribution outlets that afford them preferred access to a large customer base. The incentive to negotiate such deals will be even stronger here because AT&T/MediaOne will control access to the largest broadband customer base, favorably cache "the content developed by firms with whom it has an affiliation agreement,"[23] and discriminate against content locked outside of its network.

Finally, with respect to the merged company's ability to implement a regime of proprietary protocols, the parties claim that "both AT&T and MediaOne have used open standards in their broadband systems" and, as "the nascent player in Internet services," have "neither the incentive nor the ability to change course and impose proprietary standards in the future." Reply at 86.

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[23] Declaration of Milo Medin, attached as Appendix K to AT&T/MediaOne's Reply, at ¶ 21.

Again, this argument crumbles if one does not accept AT&T/MediaOne's assertion that the combined company will be "the nascent player in Internet services." To the contrary, AT&T/MediaOne will be the broadband market leader and will have both the incentive and ability to develop closed protocols targeted exclusively at broadband content and applications. AT&T/MediaOne's claim that it would never adopt closed proprietary network and software protocols because such "a strategy would reduce the incentive that content providers have to develop material for AT&T's platform" is therefore false. *Id.* at 86-87. AT&T/MediaOne's platform will maintain locked-in control over more than 80 percent of broadband customers until at least 2002. Accordingly, broadband content and application developers will have an overwhelming incentive to write to AT&T/MediaOne's closed system before any other.

As a result, AT&T/MediaOne will be able to defend its monopoly with the same insurmountable "applications barrier to entry" that protects Microsoft's operating system monopoly. As Hausman & Sidak conclude:

> Because AT&T is the first to the broadband residential marketplace and because the marginal cost of writing software for a second standard is substantial, software designers will likely write applications that are exclusively compatible with AT&T's standard, thereby increasing the value of AT&T's broadband network relative to other broadband networks. Those positive externalities are self-reinforcing in the sense that consumers will recognize AT&T's advantage and subscribe to AT&T's broadband network in greater numbers.[24]

To accomplish this task, it would not be necessary, as AT&T/Media One claims, to rewrite in full the "existing open, compatible standards" used to create Internet content. Reply at 87. Rather, as Parisian explains, "AT&T/MediaOne could simply develop its own proprietary security and

[24] Hausman & Sidak Reply Declaration ¶ 50.

compression algorithms -- standards application writers must follow to make their content work on AT&T/MediaOne's system." Parisian Reply Declaration ¶ 4.

The risk to the market for audio and video streaming is particularly acute. AT&T/MediaOne suggests that "vigorous competition among companies that produce this technology, and the ease with which new companies can compete, make [it] impossible" for the merged company to impose a closed standard. Reply at 97. Video streaming, AT&T/MediaOne asserts, "is simply too new a technology, developing and changing constantly, to be confined to any one approach or for any one company to emerge as its dominant provider." *Id.* at 98. AT&T/MediaOne's analysis is exactly backwards. Because there is currently a cacophony of audio and video streaming standards, the market is fragmented with no one technology acting as an industry standard. As a result, users need to have many different types of software -- from Real Networks' G2 Player, to Microsoft Media Player, to Shockwave, to Flash, to IPIX, to VMRL, to Quick Time VR, etc. -- to be able to view all of the streaming content on the Web.[25] This extreme level of standard fragmentation creates a vacuum that AT&T/MediaOne could readily fill with its own proprietary standard. As this week's *Industry Standard* notes, the "Internet Economy is still waiting for a Web multimedia standard that will make the broadband Internet a truly mainstream distribution medium."[26] AT&T/MediaOne will be able to set this standard simply by virtue of selecting a preferred multimedia player -- something the merged company will do to eliminate the need for customers to load numerous types of software and to

[25] Jimmy Guterman, *Standardize or Die*, INDUSTRY STANDARD, Nov. 1, 1999, at 50.

[26] *Id.*

spur the more rapid deployment of broadband content for its service. No anticompetitive intention is required for AT&T/MediaOne to achieve this result, but DSL and other broadband technologies will be hobbled completely if their customers are denied access to streaming audio and video content written to AT&T/MediaOne's standard.

AT&T/MediaOne concludes its argument on the combined company's ability to engage in anticompetitive behavior by suggesting that consumers will not be injured by a broadband monopoly because substitutes for broadband content are available through "audio, video, electronic, and non-electronic media." Reply at 92. Likewise, AT&T/MediaOne asserts that it will not be able to inflate prices for broadband advertising because "online advertising revenue is only a fractional component of the overall advertising market." *Id.* at 93. These arguments are truly absurd; if accepted, they would justify one firm buying up and monopolizing the whole Internet. The Commission already decided that such a result is unacceptable in its review of the MCI WorldCom merger,[27] and this transaction certainly offers no public interest benefits that compete with the growth and innovation spurred by a competitive, open Internet.

IV. UNLESS AT&T/MEDIAONE AGREES TO MERGER CONDITIONS THAT WILL STEM ITS MARKET POWER, THE COMMISSION MUST DENY THE APPLICATIONS FOR TRANSFER OF CONTROL.

Having demonstrated that a combined AT&T/MediaOne will have both an incentive and ability to monopolize the market for broadband services, GTE's job is done. The burden is now on *the parties* -- not on GTE -- to propose conditions that will tip the competitive balance back

[27] *See Application for Transfer of Control of MCI to WorldCom*, CC Docket No. 97-211, 13 FCC Rcd. 18025, at ¶¶ 142-61 (Sept. 14, 1998)

in favor of the public interest. AT&T/MediaOne's efforts to criticize GTE's proposed open access conditions therefore do nothing but set back its own cause. If, in fact, GTE's proposed conditions are illegal, uneconomical, or impractical, then the Commission must block the merger. Undoubtedly, if faced with this choice, AT&T/MediaOne would sing a different tune.

AT&T/MediaOne offers four sets of objections to GTE's proposed open access conditions: one technical, one precedential, one legal, and one practical. *First*, AT&T/MediaOne raises a host of technical objections to GTE's proposed open access conditions. Reply at 109-112. These objections are addressed comprehensively in the attached Parisian Reply Declaration. Suffice it to say here that AT&T/MediaOne is again speaking from both sides of its mouth. In Canada, where open access has already been mandated by regulators, AT&T is actively promoting GTE's suggested open architectural design: "AT&T Canada LDS submits that allowing for third party access at the equal access router . . . would be an appropriate means to allow for third parties to gain access to the transport function of the cable distribution network for the purposes of transporting . . . Internet or other on-line information services."[28]

Second, AT&T/MediaOne asserts that GTE's proposed open access conditions are inappropriate because the Commission "refused to impose" an open access requirement "in generic industry-wide proceedings earlier this year." Reply at 3. But the Commission's conclusion in that docket has no relevance here. In *this* proceeding, the risk to broadband competition stems from the combination of Excite@Home and Road Runner -- the two leading

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[28] Letter from Mark Wallace of AT&T Canada to Alan Darling, CRTC Secretary General, Mar. 6, 1997, at 1 <www.crtc.gc.ca/internet/1997/pn's/pn96-36/at&t/!9636rep.doc>.

broadband ISPs -- under common control. The Commission did not consider the competitive effects of any such combination in its "generic industry-wide proceedings." For the same reason, AT&T/MediaOne's reliance on the Commission's approval of the AT&T/TCI merger is misplaced. In that case, questions about broadband market power may have "presented a generic, rather than a merger-specific, issue," *id.* at 4, because the AT&T/TCI transaction was fundamentally a *vertical* combination between a telephone company and a cable company. The AT&T/MediaOne merger, on the other hand, will effectuate a *horizontal* combination of the two leading broadband ISPs. That combination is the source of the AT&T/MediaOne merger's anticompetitive effects -- effects that could not be more merger specific.

Third, AT&T/MediaOne offers a number of legal objections to GTE's proposed open access conditions. AT&T/MediaOne asserts that GTE's proposed open access conditions violate section 621(c) of the Cable Act because "cable Internet services easily fall within th[e] definition" of "cable services," and section 621(c) "prohibits the regulation of any cable system 'as a common carrier by reason of providing any cable service.'" *Id.* at 114-115. AT&T/MediaOne also claims that GTE's proposed conditions violate section 624(f) of the Cable Act because they constitute "regulatory interference with the programming and related decisions of cable operators." *Id.* at 120. GTE submitted a detailed rebuttal of these claims in its brief to the U.S. Court of Appeals for the Ninth Circuit in *AT&T v. City of Portland* and need not repeat its arguments here.[29] Whatever the Commission's legal authority to impose an open access

[29] *See* Opposition Brief of Defendant-Intervenor-Appellees U S WEST Interprise America, Inc., GTE Internetworking Incorporated, and OGC Telecomm, Ltd., *AT&T v. City of Portland*, No. 99-35609, at 31-46 (Sept. 7, 1999).

requirement on the cable industry generally, this is a merger proceeding and the parties are free to agree to abide by any conditions needed to make the transaction serve the public interest.[30]

The only relevant legal objection AT&T/MediaOne offers to GTE's proposed open access conditions is its assertion that the Commission lacks jurisdiction over Excite@Home and Road Runner, and therefore lacks authority to compel these entities to take action. But GTE's proposed open access conditions need not be directed at any firms other than AT&T and MediaOne, making it unnecessary for the Commission to exercise any direct jurisdiction over Excite@Home and Road Runner. GTE's conditions require that AT&T and MediaOne open their directly controlled and affiliated cable networks to competing ISPs, allowing such ISPs to interconnect on terms and conditions equivalent to those offered to AT&T/MediaOne's affiliated ISP. To the extent that this condition has the effect of requiring Excite@Home and Road Runner to make changes to their operations, these changes need not be ordered by the Commission. Ultimately, it will be AT&T/MediaOne's responsibility to assure that its contractual partners implement the necessary changes.

Fourth, AT&T/MediaOne offers a number of practical objections to GTE's proposed open access conditions. The parties begin by asserting that open access "is a meaningless slogan."

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[30] AT&T/MediaOne's assertion that GTE's proposed conditions "would require collocation with the cable operators' facilities," and that the "Commission cannot impose collocation requirements without specific statutory authority," is, for the same reason, baseless. Reply at 70. The authority AT&T/MediaOne cites for this proposition, *Bell Atlantic Tel. Co. v. FCC*, 24 F.3d 1441 (D.C. Cir. 1994), concluded that the Commission's power to compel collocation was limited by the Fifth Amendment's Takings Clause. Here, because AT&T/MediaOne would be agreeing to any conditions as a means of getting its merger approved, the combined company would have no basis for asserting that its property had been "taken" without just compensation.

Reply at 4. But GTE's proposed conditions are not meant to implement some esoteric notion of open access; rather, they are directed at solving a particular problem -- the anticompetitive effects associated with the combination of Excite@Home and Road Runner under common control. GTE is proposing a specific solution designed to addresses this problem, and nothing more. As AT&T/MediaOne itself concedes, such conditions are "appropriate" when "the risk of monopoly power is substantial enough to warrant intervention and the proposed regulation will make consumers better off." *Id.* at 71.

AT&T/MediaOne asserts that GTE's proposed open access conditions "will require extensive and ongoing government supervision to implement" and that price "regulation, with its attendant complexities, would ensue." *Id.* at 103-04. To understand why this claim is false, it is necessary to consider the two goals GTE's proposed merger conditions are intended to accomplish. One is to guarantee that AT&T/MediaOne does not exploit its market power by discriminating in the terms or pricing of ISP interconnection. Surely, the Commission should not accept any assertion by the parties that GTE's proposed conditions are inadequate because AT&T/MediaOne itself will attempt to cheat on them. If AT&T/MediaOne truly believes this to be a problem, then it can agree to a set of penalties that will keep it on the straight and narrow.

The second goal of GTE's proposed open access conditions is to assure that ISPs seeking access to AT&T/MediaOne's network cannot make unreasonable or anticompetitive demands. GTE's conditions accomplish this task by eliminating any ground for disagreement over the terms and conditions of interconnection. AT&T/MediaOne would only be required to allow competing ISPs to interconnect at the same locations AT&T/MediaOne interconnects with its affiliated ISP.

Demands for interconnection at other locations could be rejected out of hand. Moreover, because GTE's proposed implementation only requires ISPs to interconnect to an AT&T/MediaOne ISP Subscriber Manager to access the cable network, there is no need for any kind of equipment collocation. Rather, an ISP need only plug its pipe into an AT&T/MediaOne router port -- a standard form of interconnection that occurs in millions of places throughout the Internet. Likewise, GTE's proposed open access conditions would create no disputes over price. ISPs could only receive access to AT&T/MediaOne's cable network at the same price offered to an affiliated ISP. Demands for a different price could also be rejected out of hand.

Finally, AT&T/MediaOne asserts that conditioning their merger on open access would "discourage[] the necessary and valuable investment in broadband facilities." *Id.* at 107. This claim was addressed in detail in GTE's opening comments, the opening Declaration of Daniel L. Rubinfeld & J. Gregory Sidak, and the opening Declaration of Albert Parisian. At bottom, there is no question that a cable provider's investment in network upgrades is supported by multiple revenue streams, and that the provision of broadband access is a cable provider's highest-margin service. Even without guaranteed revenues from locking customers into an affiliated ISP, AT&T/MediaOne will have an unmitigated incentive to complete its network upgrades. Indeed even in Portland -- the leading battleground over open access -- AT&T's upgrade of its network "for two-way transmission will be completed next year."[31]

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[31] *Media Spoils for a Fight in Portland,* INDUSTRY STANDARD, Nov. 1, 1999 <www.thestandard.com/articles/mediagrock_display/0,1185,7341,00>.

In the end, if the Commission remains unconvinced of the efficacy of opening AT&T/MediaOne's cable system, a package of second-best conditions must, at a minimum, be imposed on AT&T/MediaOne to stem the merger's anticompetitive effects:

(1) *Require AT&T to divest its interest in Excite@Home*. This structural condition would separate control over the dominant broadband ISP from the dominant cable provider. Without any ownership interest in Excite@Home, AT&T/MediaOne would have no direct financial stake in any strategy that relies on proprietary protocols or discrimination against outside content to gain an anticompetitive advantage in the broadband market. Moreover, this condition would require no ongoing Commission supervision.

(2) *Cap the number of customers AT&T/MediaOne can serve through any one ISP*. This second structural condition would limit the number of customers AT&T/MediaOne could serve through any one ISP at the greater of (i) 2,000,000; or (ii) 50 percent of the total AT&T/MediaOne customers that have a choice of three or more ISPs. This would preclude AT&T/MediaOne from shifting all of its customers over to a single ISP in return for a share of the resulting monopoly profits. It would not, however, work any hardship on AT&T/MediaOne because neither Excite@Home nor Road Runner is close to reaching the cap; AT&T/MediaOne is only responsible for a fraction of the customers served by its affiliated ISPs; and AT&T/MediaOne's comments concede that "there are many companies that could provide cable Internet services." Reply at 89. This condition would also have the benefit of encouraging AT&T/MediaOne, without regulatory oversight, to offer consumers a choice among ISPs.

(3) *Bar AT&T/MediaOne from negotiating exclusive contracts with broadband content, software, and application developers*. This conduct-directed condition is straightforward and simple to enforce. Moreover, it should provoke no objection from AT&T/MediaOne given its contention that "content providers have no incentive to agree to such restrictions." *Id.* at 91.

(4) *Bar AT&T/MediaOne from incorporating any proprietary software, hardware, or protocols into the content, applications, or equipment associated with its provision of broadband services*. This conduct-directed condition would guarantee that AT&T/MediaOne does not gain an anticompetitive advantage by promoting the development of applications and customer equipment that work only with its own service. It could be readily be administered by incorporating the two following definitions into the condition's text:

- *Protocol* means "a formal description of message formats and the rules two or more machines must follow to exchange those messages."
- *Proprietary,* as it relates to protocol, means "the creation or use of a complete copyrighted or patented protocol, or the invention or use of a copyrighted or patented means of employing unused header space or reserved payload space in an existing protocol."

This condition should likewise provoke no opposition from AT&T/MediaOne given its assertion that "AT&T has neither the incentive nor the ability to change course and impose proprietary standards in the future." *Id.* at 86.

GTE does not believe these conditions will promote consumer welfare as well as the open access conditions detailed in its opening comments.[32] In particular, GTE's proposed open access conditions will promote the rapid roll-out of IP telephony, because every ISP on an open cable system can offer IP telephony without making *any* changes to the form of interconnection with AT&T/MediaOne. Nevertheless, GTE does believe that this second-best set of conditions would help to mitigate the competitive foreclosure problems created by the pending merger.

V. DENYING THE APPLICATIONS FOR TRANSFER OF CONTROL WOULD NOT DENY CONSUMERS ANY PUBLIC INTEREST BENEFIT.

Should the Commission conclude that no merger conditions are either workable or sufficient to alleviate the harm the AT&T/MediaOne merger will inflict on broadband consumers, the parties' applications for transfer of control must be denied. The Commission should not feel

[32] Again, while these conditions would help to mitigate the competitive concerns created by this merger, they would not eliminate in any way the antitrust violations raised by GTE in a private suit recently filed against TCI, Comcast, and Excite@Home. *See GTE Internetworking v. Tele-Communications, Inc.*, Case No. 99-1737, Complaint (W.D. Pa. Oct. 25, 1999). So long as TCI, Comcast, and Excite@Home customers remain unable to choose their own ISP, they will be subject to the private-suit defendants' unlawful tying and exclusive dealing scheme.

any trepidation about this result, as AT&T/MediaOne's asserted procompetitive benefits are neither real nor merger specific.

AT&T and MediaOne offer two procompetitive benefits to support their merger. *First*, the parties devote six pages of their Reply to an argument that "AT&T's enormous investment in cable facilities and its demonstrated commitment to deliver new competing services" is spurring ILECs to roll out DSL more quickly. *Id.* The problem with this argument is that is confuses the benefits of cable modem investment *generally* with the benefits of the AT&T/MediaOne merger. While it may be the case that cable modem deployment spurs all potential competitors (not just ILECs) to roll out competing broadband technologies, AT&T/MediaOne has offered no proof that its merger is responsible for this effect. The one example AT&T/MediaOne offers that is specific to GTE -- GTE's recent deal to offer DSL customers the ability to choose AOL as their ISP, *id.* at 11 -- was in the works long before the parties' merger was announced.

Moreover, AT&T/MediaOne's assertion that the announcement of its merger "triggered nothing less than a competitive avalanche" of DSL deployment in MediaOne territory is an empirically testable proposition[33] -- and it is false. As explained in detail in paragraphs 80 through 83 of the Hausman & Sidak Reply Declaration, an econometric analysis of the rate of DSL deployment in MediaOne territory pre- and post-merger announcement confirms that AT&T's proposed union with MediaOne did nothing to "stimulate DSL deployment." Hausman & Sidak Reply Declaration ¶ 83.

[33] Ordover & Willig Declaration ¶ 51.

Second, AT&T/MediaOne claims that the merger "will produce profound public benefits by allowing the more rapid and effective development of a facilities-based alternative to ILECs." Reply at 1. Plain and simple, this benefit -- whatever its actual magnitude -- can be achieved by a joint venture that does not consolidate control of Excite@Home and Road Runner in the hands of one dominant firm. AT&T/MediaOne complains that no "such joint venture arrangements have ever been worked out," arguing that "when a vertical supply relationship requires substantial contract-specific investment in an uncertain economic environment, vertical integration by merger is likely to be the preferred alternative to contracting." *Id.* at 18-20. The parties conclude that joint ventures to offer cable telephony are unlikely to succeed due to "the costs of research and development, licenses and permitting, acquisition of real estate and capital assets, installation of cable and customer premises equipment, marketing and advertising, and staffing of customer care centers." *Id.* at 21.

But telecommunications companies surmount these hurdles routinely when negotiating joint venture agreements for the development of specific new products and services, such as cable telephony. The Commission recently approved an international joint venture between AT&T and British Telecom ("BT"), for example, that will "replace AT&T's and BT's existing circuit-switched international facilities with a state-of-the-art Internet Protocol-based global network."[34] This new network "will offer high-speed transport capacity to the world's largest cities," and "further the development of packet-switched international networks and facilitate the migration

[34] *Commission Approves AT&T/BT Request to Obtain or Transfer Licenses to Joint Venture to Provide International Services*, Press Release, Oct. 22, 1999, at 1.

from the circuit switched network."[35] There is no doubt that this joint venture will have to divide between AT&T and BT "the costs of research and development, licenses and permitting, acquisition of real estate and capital assets, installation of cable and customer premises equipment, marketing and advertising, and staffing of customer care centers." *Id.* at 21. Nevertheless, the deal was done.

AT&T/MediaOne confesses that it has "vigorous and still-ongoing efforts to negotiate joint ventures," is "continu[ing] to negotiate" with Time Warner, and plans "to offer customers across the nation" cable telephone service. *Id.* at 19, 22-23.[36] If the Commission approves the pending merger, there is no doubt that these other joint venture agreements will rapidly be concluded. AT&T/MediaOne attempts to deflect attention from this fact by asserting that AT&T "and Time Warner have been unable to reach agreement on actual joint venture terms, and the 90-day 'drop dead' date specified in the letter of intent for completion of all negotiations has long since expired." *Id.* at 22. Conveniently, the parties fail to mention that their merger was announced just days before the 90-day period expired, and that AT&T itself called off the joint venture negotiations until the AT&T/MediaOne merger passed regulatory scrutiny. As AT&T's

[35] *Id.*

[36] *See also* Declaration of Douglas D. Holmes, Appendix C to Reply Comments, at ¶ 7 ("I understand that AT&T and others are continuing to work hard to find ways to minimize the risks associated with their uncertainties and to achieve joint venture arrangements."); Declaration of W. Terrell Wingfield, Jr., Appendix D to reply Comments, at ¶ 3 (AT&T has "ongoing" efforts "in full force" to establish joint ventures with "numerous cable companies").

Chairman stated, "With time Warner, we do have to complete the [MediaOne] transaction before we can sit down and negotiate."[37]

The reason for AT&T's abrupt about-face is clear. If AT&T had concluded a joint venture agreement with Time Warner, it would have had absolutely no basis to argue that it needed to merge with MediaOne. If the Commission blocks the AT&T/MediaOne merger, AT&T will nevertheless re-commence its joint venture negotiations with Time Warner and other cable providers, including MediaOne. The parties' merger is therefore not necessary to achieve any asserted benefits in the market for local telephony. To the extent that the AT&T/MediaOne merger presents any threat to the market for broadband services that cannot be eliminated by ameliorative conditions, the parties' applications for transfer of control should be denied.

[37] Rebecca Blumenstein, *AT&T Puts Cable Agreements on Hold*, WALL ST. J., May 20, 1999, at B9.

CONCLUSION

For the foregoing reasons, GTE respectfully requests that the Commission deny AT&T and MediaOne's applications for transfer of control. Alternatively, the Commission can address the merger's anticompetitive impacts on the market for broadband Internet service by imposing GTE's proposed merger conditions.

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CERTIFICATE OF SERVICE

I, John P. Frantz, certify that two copies of the foregoing Ex Parte Reply Comments of GTE Service Corporation, GTE Internetworking, and GTE Media Ventures, Inc. Supporting Denial of Applications or Conditioning Merger on Open Access Requirements, were served by first-class mail, postage prepaid, on the following:

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